

§ 25.2702-4

26 CFR Ch. I (4-1-12 Edition)

the stated annuity for 10 years or until A's prior death). B's interest is not a qualified interest and is thus valued at zero under section 2702.

(f) *Qualified remainder interest*—(1) *Requirements.* An interest is a qualified remainder interest only if it meets all of the following requirements:

(i) It is a qualified remainder interest in every respect.

(ii) It meets the definition of and functions exclusively as a qualified interest from the creation of the interest.

(iii) It is non-contingent. For this purpose, an interest is non-contingent only if it is payable to the beneficiary or the beneficiary's estate in all events.

(iv) All interests in the trust, other than non-contingent remainder interests, are qualified annuity interests or qualified unitrust interests. Thus, an interest is a qualified remainder interest only if the governing instrument does not permit payment of income in excess of the annuity or unitrust amount to the holder of the qualified annuity or unitrust interest.

(2) *Remainder interest.* Remainder interest is the right to receive all or a fractional share of the trust property on termination of all or a fractional share of the trust. Remainder interest includes a reversion. A transferor's right to receive an amount that is a stated or pecuniary amount is not a remainder interest. Thus, the right to receive the original value of the trust corpus (or a fractional share) is not a remainder interest.

(3) *Examples.* The following examples illustrate rules of this paragraph (f). Each example assumes that all applicable requirements of a qualified interest are met unless otherwise specifically stated.

Example 1. A transfers property to an irrevocable trust. The income of the trust is payable to A's child for life. On the death of A's child, the trust is to terminate and the trust corpus is to be paid to A. A's remainder interest is not a qualified remainder interest because the interest of A's child is neither a qualified annuity interest nor a qualified unitrust interest.

Example 2. The facts are the same as in *Example 1*, except that A's child has the right to receive the greater of the income of the trust or \$10,000 per year. A's remainder interest is

not a qualified remainder interest because the right of A's child to receive income in excess of the annuity amount is not a qualified interest.

Example 3. A transfers property to an irrevocable trust. The trust provides a qualified annuity interest to A's child for 12 years. An amount equal to the initial value of the trust corpus is to be paid to A at the end of that period and the balance is to be paid to A's grandchild. A's interest is not a qualified remainder interest because the amount A is to receive is not a fractional share of the trust property.

Example 4. U transfers property to an irrevocable trust. The trust provides a qualified unitrust interest to U's child for 15 years, at which time the trust terminates and the trust corpus is paid to U or, if U is not then living, to U's child. Because U's remainder interest is contingent, it is not a qualified remainder interest.

[T.D. 8395, 57 FR 4267, Feb. 4, 1992, as amended by T.D. 8536, 59 FR 23157, May 5, 1994; T.D. 8633, 60 FR 66090, Dec. 21, 1995; T.D. 8899, 65 FR 53588, Sept. 5, 2000; 65 FR 70792, Nov. 28, 2000; T.D. 9181, 70 FR 9224, Feb. 25, 2005]

§ 25.2702-4 Certain property treated as held in trust.

(a) *In general.* For purposes of section 2702, a transfer of an interest in property with respect to which there are one or more term interests is treated as a transfer in trust. A term interest is one of a series of successive (as contrasted with concurrent) interests. Thus, a life interest in property or an interest in property for a term of years is a term interest. However, a term interest does not include a fee interest in property merely because it is held as a tenant in common, a tenant by the entirety, or a joint tenant with right of survivorship.

(b) *Leases.* A leasehold interest in property is not a term interest to the extent the lease is for full and adequate consideration (without regard to section 2702). A lease will be considered for full and adequate consideration if, under all the facts and circumstances as of the time the lease is entered into or extended, a good faith effort is made to determine the fair rental value of the property and the terms of the lease conform to the value so determined.

(c) *Joint purchases.* Solely for purposes of section 2702, if an individual acquires a term interest in property and, in the same transaction or series of transactions, one or more members

of the individual's family acquire an interest in the same property, the individual acquiring the term interest is treated as acquiring the entire property so acquired, and transferring to each of those family members the interests acquired by that family member in exchange for any consideration paid by that family member. For purposes of this paragraph (c), the amount of the individual's gift will not exceed the amount of consideration furnished by that individual for all interests in the property.

(d) *Examples.* The following examples illustrate rules of this section:

Example 1. A purchases a 20-year term interest in an apartment building and A's child purchases the remainder interest in the property. A and A's child each provide the portion of the purchase price equal to the value of their respective interests in the property determined under section 7520. Solely for purposes of section 2702, A is treated as acquiring the entire property and transferring the remainder interest to A's child in exchange for the portion of the purchase price provided by A's child. In determining the amount of A's gift, A's retained interest is valued at zero because it is not a qualified interest.

Example 2. K holds rental real estate valued at \$100,000. K sells a remainder interest in the property to K's child, retaining the right to receive the income from the property for 20 years. Assume the purchase price paid by K's child for the remainder interest is equal to the value of the interest determined under section 7520. K's retained interest is not a qualified interest and is therefore valued at zero. K has made a gift in the amount of \$100,000 less the consideration received from K's child.

Example 3. G and G's child each acquire a 50 percent undivided interest as tenants in common in an office building. The interests of G and G's child are not term interests to which section 2702 applies.

Example 4. B purchases a life estate in property from R, B's grandparent, for \$100 and B's child purchases the remainder interest for \$50. Assume that the value of the property is \$300, the value of the life estate determined under section 7520 is \$250 and the value of the remainder interest is \$50. B is treated as acquiring the entire property and transferring the remainder interest to B's child. However, the amount of B's gift is \$100, the amount of consideration (\$100) furnished by B for B's interest.

Example 5. H and W enter into a written agreement relative to their marital and property rights that requires W to transfer property to an irrevocable trust, the terms

of which provide that the income of the trust will be paid to H for 10 years. On the expiration of the 10-year term, the trust is to terminate and the trust corpus is to be paid to W. H and W divorce within two years after the agreement is entered into. Pursuant to section 2516, the transfer to H would otherwise be deemed to be for full and adequate consideration. Section 2702 does not apply to the acquisition of the term interest by H because no member of H's family acquired an interest in the property in the same transaction or series of transactions. The result would not be the same if, on the termination of H's interest in the trust, the trust corpus were distributable to the children of H and W rather than W.

[T.D. 8395, 57 FR 4269, Feb. 4, 1992]

§ 25.2702-5 Personal residence trusts.

(a)(1) *In general.* Section 2702 does not apply to a transfer in trust meeting the requirements of this section. A transfer in trust meets the requirements of this section only if the trust is a personal residence trust (as defined in paragraph (b) of this section). A trust meeting the requirements of a qualified personal residence trust (as defined in paragraph (c) of this section) is treated as a personal residence trust. A trust of which the term holder is the grantor that otherwise meets the requirements of a personal residence trust (or a qualified personal residence trust) is not a personal residence trust (or a qualified personal residence trust) if, at the time of transfer, the term holder of the trust already holds term interests in two trusts that are personal residence trusts (or qualified personal residence trusts) of which the term holder was the grantor. For this purpose, trusts holding fractional interests in the same residence are treated as one trust.

(2) *Modification of trust.* A trust that does not comply with one or more of the regulatory requirements under paragraph (b) or (c) of this section will, nonetheless, be treated as satisfying these requirements if the trust is modified, by judicial reformation (or non-judicial reformation if effective under state law), to comply with the requirements. In the case of a trust created after December 31, 1996, the reformation must be commenced within 90 days after the due date (including extensions) for the filing of the gift tax return reporting the transfer of the